



## SECURITIES AND EXCHANGE COMMISSION

[Investment Company Act Release No. 34688; 812-15226]

### Capital Southwest Corporation

August 25, 2022.

**AGENCY:** Securities and Exchange Commission (“Commission”).

**ACTION:** Notice.

Notice of an application under section 6(c) of the Investment Company Act of 1940 (the “Act”) for an exemption from section 12(d)(3) of the Act.

Summary of Application: Applicant requests an order to permit a business development company (“BDC”) to organize, acquire, and wholly-own a portfolio company that intends to operate as an investment adviser registered under the Investment Advisers Act of 1940 (the “Advisers Act”).

Applicant: Capital Southwest Corporation (the “Company” or “Applicant”).

Filing Dates: The application was filed on April 30, 2021, and amended on September 1, 2021, February 28, 2022, and May 31, 2022.

Hearing or Notification of Hearing: An order granting the requested relief will be issued unless the Commission orders a hearing. Interested persons may request a hearing by e-mailing the Commission’s Secretary at [Secretarys-Office@sec.gov](mailto:Secretarys-Office@sec.gov) and serving Applicant with a copy of the request, by e-mail. Hearing requests should be received by the Commission by 5:30 p.m. on September 19, 2022 and should be accompanied by proof of service on the applicant, in the form of an affidavit, or for lawyers, a certificate of service. Pursuant to rule 0-5 under the Act, hearing requests should state the nature of the writer’s interest, any facts bearing upon the desirability of a hearing on the matter, the reason for the request, and the issues contested. Persons who wish to be notified of a hearing may request notification by e-mailing the Commission’s Secretary at [Secretarys-Office@sec.gov](mailto:Secretarys-Office@sec.gov).

Addresses: The Commission: Secretarys-Office@sec.gov. Applicant: Michael S. Sarner, Chief Financial Officer, Secretary and Treasurer, Capital Southwest Corporation at MSarner@capitalsouthwest.com.

**FOR FURTHER INFORMATION CONTACT:** Kieran G. Brown, Senior Counsel, or Kaitlin C. Bottock, Branch Chief, at (202) 551-6825 (Division of Investment Management, Chief Counsel's Office).

**SUPPLEMENTARY INFORMATION:** For Applicants' representations, legal analysis, and conditions, please refer to Applicants' first amended and restated application, dated March 17, 2022, which may be obtained via the Commission's website by searching for the file number at the top of this document, or for an Applicant using the Company name search field, on the SEC's EDGAR system. The SEC's EDGAR system may be searched at <https://www.sec.gov/edgar/searchedgar/legacy/companysearch.html>. You may also call the SEC's Public Reference Room at (202) 551-8090.

#### Company and Adviser Sub

1. The Company is a Texas corporation that operates as an internally managed, non-diversified, closed-end management investment company. The Company has elected to be regulated as a BDC under the Act. The Company's investment objective is to produce attractive risk-adjusted returns by generating current income from its debt investments and capital appreciation from its equity and equity related investments. The Company's investment strategy is to partner with business owners, management teams and financial sponsors to provide flexible financing solutions to fund growth, changes of control, or other corporate events.

2. Capital Southwest Asset Management LLC ("Adviser Sub") was formed as a limited liability company under the laws of the State of Delaware and will be a direct or an indirect wholly owned portfolio company of the Company.<sup>1</sup> As discussed below, the Adviser

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<sup>1</sup> Adviser Sub will be a wholly owned portfolio company of the Company and will also fall within the definition of "wholly owned subsidiary" for purposes of section 2(a)(43) of the Act.

Sub intends to operate as an investment adviser registered with the Commission under the Advisers Act.<sup>2</sup> The Company expects the Adviser Sub to receive fees in connection with its management of one or more privately-offered pooled investment vehicles, registered management investment companies, BDCs, and/or investment accounts (collectively, “Managed Accounts”) similar to those received by comparable investment advisers.

3. The Company is, and the Adviser Sub will be, directly or indirectly overseen by the Company’s seven-member Board of Directors (the “Board”), of whom six are not considered “interested persons” of the Company within the meaning of section 2(a)(19) of the Act. In its capacity as the Board of the Advisers Sub’s parent company, the Board will indirectly oversee the Adviser Sub.

4. The Company has elected to be treated for U.S. federal income tax purposes, and intends to qualify annually, as a regulated investment company (“RIC”) under Subchapter M of the Internal Revenue Code of 1986, as amended (the “Code”). Applicant states that as a RIC, the Company generally will not pay corporate-level federal income taxes on any net ordinary income or capital gains that it distributes to its stockholders as dividends in accordance with the timing requirements of the Code. To maintain its RIC status, the Company must, among other things, meet specified source-of-income requirements. Applicant states that the Company will satisfy the source-of-income test for purposes of qualifying as a RIC if it derives in each taxable year at least 90% of its gross income from dividends, interest, payments with respect to certain securities loans, gains from the sale of stock or other securities or currencies, net income from certain “qualified publicly traded partnerships” (as defined in the Code) or other income derived with respect to its business of investing in such stock, securities or currencies (income from such sources, “Good RIC Income”).

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<sup>2</sup> Adviser Sub has been formed, but it does not intend to commence operations unless and until the relief requested in the application has been granted.

5. Applicant states that fee income received in connection with the provision of services to the Managed Accounts generally would not constitute Good RIC Income to the Company if it earned such income directly. Therefore, in order for the Company to maintain its RIC status while receiving the income from the provision of advisory services to the Managed Accounts, the Company believes that it is in the best interests of the Company and its shareholders for the Adviser Sub to provide advisory services to and to receive fees from the Managed Accounts instead of the Company providing such services and receiving such fees directly.

6. Under the Advisers Act, an investment adviser is generally required to be registered if it has \$100 million or more of regulatory assets under management.<sup>3</sup> An investment adviser may also register under the Advisers Act in compliance with rule 203A-2(c)(1) of the Advisers Act if it expects to be eligible to register as an adviser within 120 days of registering. Applicant states that the Adviser Sub will register as an investment adviser under the Advisers Act in compliance with rule 203A-2(c)(1) of the Advisers Act after the relief requested in the application is granted to the Company because the Adviser Sub expects to have \$100 million or more of regulatory assets under management within 120 days of such registration.

#### Applicable Law

1. Section 12(d)(3) makes it unlawful for any registered investment company, and any company controlled by a registered investment company, to acquire any interest in the business of a person who is either an investment adviser of an investment company or an investment adviser registered under the Advisers Act, unless (a) such person is a corporation all the outstanding securities of which are owned by one or more registered investment companies; and (b) such person is primarily engaged in the business of underwriting and distributing securities

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<sup>3</sup> In addition, an investment adviser to an investment company registered under the Act or to a company that has elected to be a BDC with \$25 million or more of regulatory assets under management would also be required to register under the Advisers Act. Applicants state that the Adviser Sub also may act as an investment adviser to an investment company registered under the Act or to a company that has elected to be a BDC with \$25 million or more of regulatory assets under management after the relief requested is granted.

issued by other persons, selling securities issued by other persons, selling securities to customers, or any one or more of such or related activities, and the gross income of such person normally is derived principally from such business or related activities. Section 60 of the Act states that section 12 shall apply to a BDC to the same extent as if it were a registered closed-end investment company.

2. Section 6(c) of the Act provides that the Commission may exempt any person or transaction from any provision of the Act if and to the extent that such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Act.

#### Applicant's Legal Analysis

1. Applicant represents that the Company will own 100% of the equity interests in the Adviser Sub. However, Applicant states that it is not expected that the Adviser Sub would also be a broker-dealer that is primarily engaged in the business of underwriting and distributing securities issued by other persons. The ownership of the Adviser Sub, at such point as it becomes registered as an investment adviser, could thus cause the Company to be in violation of the provisions of section 12(d)(3) unless the requested Order is issued.<sup>4</sup> In addition, the Company expects that after the relief requested in the application is granted the Adviser Sub will act as an investment adviser to investment companies. To the extent it does so, relief from section 12(d)(3) is also required because the Adviser Sub acting as an investment adviser of an investment company would result in the Company acquiring a security of an investment adviser of an investment company. Therefore, Applicant requests the Order pursuant to section 6(c) of the Act granting an exemption from the provisions of section 12(d)(3) of the Act, to the extent

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<sup>4</sup> Rule 12d3-1(a) and (b) under the Act each provides limited relief from the restrictions of section 12(d)(3) if the acquired company derives 15 percent or less of its gross revenues from securities related activities (as defined in the rule) or the acquiring company owns not more than five percent of the outstanding securities of that class of the acquired company's equity securities. The Company does not believe that it may rely on this relief with respect to its investment in Adviser Sub, since the Company expects that a significant portion of the Adviser Sub's gross revenues will be derived from securities related activities and the Company will own all of the outstanding securities of the Adviser Sub.

necessary in order to permit the Company to organize, acquire, and wholly own the securities of the Adviser Sub.

2. Applicant states that section 12(d)(3) was intended to: (a) limit the risk of a registered investment company's exposure to the entrepreneurial risks, or general liabilities, that are peculiar to securities-related businesses; and (b) prevent potential conflicts of interest and reciprocal practices between investment companies and securities-related businesses. Applicant submits that the Company's ownership and control of the Adviser Sub does not present the concerns against which section 12(d)(3) was intended to safeguard.

3. Applicant states that much of the concern regarding entrepreneurial risks stemmed from the fact that when section 12(d)(3) was adopted, most securities-related businesses were organized as privately held general partnerships. As a result, an investment in such a company would expose an investment company to the unlimited liabilities of a general partner. Applicant notes that today's financial services industry is subject to a much more robust body of regulation, which contributes to a more conservative risk profile for those companies that comprise the industry. Moreover, Applicant states that the risks presented by the form of organization of a securities-related business are no longer as germane as they were at the time of the adoption of section 12(d)(3) because many formerly closely-held securities-related businesses have reorganized into corporate forms that are characterized by limited liability. Applicant asserts in particular that the Company's shareholders are not exposed to the risk of unlimited liability associated with an interest in the Adviser Sub because they are insulated by a layer of liability protection between the Adviser Sub and the Company, as the Adviser Sub is a separate entity and is structured as a limited liability company, not a partnership.

4. Applicant also submits that the Company will own 100% of the equity interests in the Adviser Sub and, as a result, will exercise total control over the strategic direction of the Adviser Sub, including the power to control the policies that affect the Company and to protect the Company from potential conflicts of interest and reciprocal practices. Moreover, as a wholly

owned portfolio company and the sole shareholder of the Adviser Sub, the Adviser Sub and the Company will generally have aligned interests.

5. Applicant states that the Company will adopt policies and procedures with respect to the Adviser Sub designed to ensure that the Company and the Adviser Sub are both being operated and managed in the best interests of the Company's shareholders and that the ownership by the Company of the Adviser Sub is consistent with the purposes fairly intended by the policy and provisions of the Act.<sup>5</sup> Applicant states that the Company and the Adviser Sub will adopt policies and procedures to address potential conflicts of interest, including but not limited to policies and procedures that govern the allocation of expenses, personal securities trading, and insider trading and confidentiality of proprietary information.

6. Applicant notes that the Company and the Managed Accounts may invest in the same securities or different securities of the same issuer to the extent consistent with applicable law, regulatory guidance, or any exemptive order obtained by the Company. The Company and the Adviser Sub will implement policies and procedures that will govern the allocation of investment opportunities when investment advisory personnel of the Company and/or Adviser Sub become aware of investment opportunities that may be appropriate for the Company and one or more Managed Accounts.

7. Applicant states that the Company's proposal to enter into the advisory business through a wholly owned and controlled portfolio company will benefit the Company's shareholders by: (a) allowing them to share in the profits from the new advisory business; (b) allowing that advisory business to be more marketable than if the services were provided by the Company itself; and (c) limiting any potential liabilities arising from Adviser Sub's provision of advisory services. In addition, the growth in the Company's advisory business through the

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<sup>5</sup> Applicant represents that the Adviser Sub's borrowings, if any, would be used only for its own legitimate business purposes, and would not be used directly or indirectly by the Company for its business purposes unrelated to the Adviser Sub, and that the Company will adopt procedures to ensure Board oversight of compliance with this representation.

Adviser Sub will enable the Company to add advisory personnel that it could not on its own, such as additional portfolio managers and investment analysts, who will be available to provide advisory services both to the Company and to the Managed Accounts of the Adviser Sub and further enhance the experience and relationships of the Company's investment team. Without the growth of the Company's advisory business through the Adviser Sub, the Company would not have the ability to support such additional advisory personnel. Applicant also states that the Adviser Sub's organization as a wholly owned portfolio company of the Company and registration as an investment adviser would permit the Adviser Sub to operate the business of managing the Managed Accounts as a direct or an indirect wholly owned taxable portfolio company of the Company, thereby protecting the Company's RIC status.

8. Applicant represents that the Company's Board, including a majority of the disinterested directors, found that the Company organizing, acquiring, and wholly owning 100% of the equity interest in the Adviser Sub subsequent to its registration as an investment adviser is in the best interests of the Company and its shareholders. Applicant agrees that the Board will review at least annually the investment advisory business of the Adviser Sub to determine whether such business should be continued and whether the benefits derived by the Company from the Adviser Sub's business warrant the continued ownership of the Adviser Sub. Applicant states that shareholders of the Company will be provided with notice, in advance of, or concurrent with, the Adviser Sub's start of investment advisory activities.

9. Accordingly, Applicant represents that the requested relief is both necessary and appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Act.

Applicant's Conditions:

Applicant agrees that the Order of the Commission granting the requested relief shall be subject to the following conditions:



1. The determination to enter into the advisory business through the Adviser Sub has been made by a vote of at least a majority of the Board who are not “interested persons” of the Company as defined in section 2(a)(19).

2. The Company will wholly own and control the Adviser Sub. The Company will not have an investment adviser within the meaning of section 2(a)(20). Only persons acting in their capacities as directors, officers or employees of the Company will provide advisory services to the Company.

3. In each of its annual reports to shareholders and in future registration statements, the Company will discuss the existence of the Adviser Sub and the provision by the Adviser Sub of outside advisory services as well as include an assessment of whatever risks, if any, are associated with the existence of the Adviser Sub and its provision of such services.

4. The Adviser Sub will not make any proprietary investment that the Company would be prohibited from making directly under the Company’s investment objectives, policies and restrictions or under any applicable law.

5. In assessing compliance with the asset coverage requirements under section 18 of the Act, the Company will deem the assets, liabilities, and indebtedness of the Adviser Sub as its own.

6. The Board will review at least annually the investment advisory business of the Adviser Sub to determine whether such business should be continued and whether the benefits derived by the Company from the Adviser Sub’s business warrant the continued ownership of the Adviser Sub and, if appropriate, approve (by a vote of at least a majority of its directors who are not “interested persons” as defined in the Act) at least annually such continuation. In determining whether the investment advisory business of the Adviser Sub should be continued and whether the benefits derived by the Company from the Adviser Sub’s business warrant the continued ownership of the Adviser Sub, the Board will take into consideration, among other things, the following: (a) the compensation of the officers of the Company and of the Adviser

Sub; (b) all investments by and investment opportunities considered for the Company that relate to any investments by or investment opportunities considered for a client of the Adviser Sub; and (c) the allocation of expenses associated with the provision of advisory services between the Company and the Adviser Sub.<sup>6</sup>

For the Commission, by the Division of Investment Management, under delegated authority.

**J. Matthew DeLesDernier,**

*Deputy Secretary.*

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<sup>6</sup> Such expenses may include: administration and operating expenses; investment research expenses; sales and marketing expenses; office space and general expenses; and direct expenses, including legal and audit fees, directors' fees and taxes.